Amending Vietnam's Constitution: Why Washington Cares

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On October 21, Vietnam's National Assembly convened in Hanoi for a month-long meeting during which lawmakers are expected to ratify a new constitution. As the lawmakers meet, Vietnam's economy continues to grow steadily, as it has throughout the year, but at about 2 percent less than the government's annual target of 7 percent growth. Other issues poised to be addressed at the meeting include the restructuring of the banking system, discussions on the future economic plan, and amendments to current land laws.

Vietnam has emerged as an increasingly important U.S. partner in the Asia Pacific. In July, less than 20 years after the two countries normalized diplomatic ties, U.S. president Barack Obama and his visiting Vietnamese counterpart, Truong Tan Sang, agreed to form a comprehensive partnership to take the U.S.-Vietnam relationship to the next level. In this context, U.S. policymakers have been paying more attention to developments inside Vietnam, especially those with long-term implications. One of those developments is the amendment of Vietnam's constitution, which was written in 1992.

While human rights groups have been calling for the new constitution to embrace multiparty elections, another important amendment up for discussion—and one the U.S. government should care about—is Article 19, which assigns state-owned enterprises (SOEs) a leading role in Vietnam's economy. This means that government policies until now were formulated to give state enterprises easier access to land and capital and subject them to minimal legal restrictions. Amending the SOE clause is a high-stakes issue, not just for the future trajectory of Vietnam itself, but also for its growing commercial ties with the world and with the United States in particular.

During a much-publicized interview with Bloomberg in New York last month, Vietnamese prime minister Nguyen Tan Dung pledged to reform the country's state-owned sector and create a level playing field between Vietnamese SOEs and foreign businesses over the next five years. According to Dung, Vietnam's SOEs will in the long run focus mainly on public infrastructure and sectors in which private investors are restricted, while leaving other sectors of the economy, most notably banking and finance, open to competition.

Dung's visit to New York was part of Hanoi's ongoing push to continue attracting foreign investors to Vietnam as economic growth has cooled in recent years. When President Sang met with President Obama and top U.S. trade officials in July, he reaffirmed Vietnam's commitment to conclude negotiations on the Trans-Pacific Partnership (TPP) trade agreement with the United States and 10 other countries, and at the same time called for U.S. support to facilitate Vietnam's entrance into the pact. One of the chapters in the TPP involves countries agreeing to provide a level playing field between SOEs and private business.

Amending Article 19 is a highly controversial topic for Vietnam's ruling elite, which has recently taken some bold steps such as holding an unprecedented vote of confidence in top government and Communist Party officials this past summer. For Hanoi, the large state-owned sector represents its strong grip on the economy. More conservative leaders prefer to leave the SOE provision intact, citing a need to support the country's "progress toward a socialist economy," and to ignore the enormous role of foreign and private domestic capital in turning Vietnam into one of the most attractive investment destinations in the region and one of the world's top exporters of rice, garments, sports shoes, and furniture.

Since Vietnam launched market economic reforms in the late 1980s, SOEs have remained an important part of the economy and a driver of growth in the early stages of reforms, accounting for around 40 percent of economic output. Yet, while Vietnam has become more open to foreign investment since the mid-2000s and a domestic entrepreneurial class has emerged in the country, SOEs have posted huge losses, with many heavily indebted to state-owned banks because of unsuccessful investments outside the companies' areas of expertise.

The dilemma for Hanoi is that, while its leaders understand the need to restructure SOEs and the economy as a whole, they hope to do so while preserving a major role for the Vietnamese state sector well into the future. This is not to say that Vietnam has not made progress on reforming its state enterprises. In recent years, the number of companies that are wholly owned by the government has shrunk from 12,000 to approximately 1,300.

U.S. officials point out that Vietnam has been one of the most cooperative negotiating partners in the TPP, even in areas as difficult as SOEs and market access. The future of SOEs in Vietnam is entwined with the TPP, which in principle will require members to place all businesses, state-owned or private, on a level playing field. Against this backdrop, Hanoi's failure to ratify a more market-friendly and much-expected provision limiting the role of SOEs would be disappointing for U.S. companies. It would also send conflicting signals about Vietnam's seriousness and credibility, especially following President Sang's and Prime Minister Dung's visits to the United States over the past three months.

One of the incentives for the government to revise the SOE provision in the constitution is that foreign investment has slowed in recent years. Last year, foreign investment made up 51.6 percent of Vietnam's gross domestic product, down from 53.3 percent in 2010; the average figure for all of Southeast Asia was 56.4 percent. Short of a breakthrough policy change at a time when its labor costs continue to rise, Vietnam may in the long run risk falling behind other fast-rising economies in the region, such as Cambodia and Myanmar, in terms of attractiveness to foreign capital.

That said, Vietnam remains an attractive destination for foreign investors. In a new ASEAN business outlook survey published jointly by the U.S. Chamber of Commerce and the American Chamber of Commerce in Singapore, U.S. business executives surveyed cited Vietnam as the second-most-attractive destination for new business expansion in Southeast Asia, after Indonesia. The country has alsoemerged as a production base for global high-tech companies. But having a two-tier economy, in which foreign-invested, export-driven businesses and state-owned businesses are moving in opposite directions, has greatly hampered the country's growth potential as well as its overall competitiveness in attracting foreign investment in coming years.

Ensuring that market-friendly provisions are enshrined in the constitution would give renewed confidence to international investors and be seen as demonstrating the government's commitment to meaningful economic reforms. As Washington and Hanoi intensify their talks to upgrade economic ties within the TPP, the U.S. government and private sector would like to see steps taken by Hanoi that would reinforce Vietnam's earlier reform pledge and, more importantly, indicate its stature as a credible partner.

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